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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

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2011 MAR 22 P 4: 25

Arizona Corporation Commission

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MAR 22 2011

ARIZONA CORP COMMISSION
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In the matter of:

Docket No. S-20772A-10-0489

ARTHUR BRENT PAYNE and CAROLYN L.
PAYNE, husband and wife,

MICHAEL RICHARD OLSON and JANE DOE
OLSON, husband wife,

STEEPLE ROCK FUNDING, L.L.C., an Arizona
limited liability company,

GRANITE LOAN FUND, L.L.C., an Arizona
limited liability company,

Respondents.

**RESPONDENTS' REPLY
IN SUPPORT OF
MOTION FOR ORDER DIRECTING
THE EXECUTIVE SECRETARY TO
ISSUE A SUBPOENA FOR THE
DEPOSITION TESTIMONY OF
INVESTIGATOR CLYDE J. ("C.J.")
HANSELMAN**

**Status Conference: March 24, 2011
(9:00 AM)**

Respondents Arthur Brent Payne, Carolyn L. Payne, Michael Richard Olson, Jane Doe Olson, Steeple Rock Funding, L.L.C. ("SRF") and Granite Loan Fund, L.L.C. ("GLF") (collectively "Respondents") reply in support of their motion for an order to compel the deposition testimony of Securities Division Special Investigator Clyde J. ("C.J.") Hanselman.

I. Preliminary Statement.

Respondents want to depose Special Investigator Hanselman – the undercover agent whose investigation led to the Division's TCD¹ and who is mentioned (as the "first potential Arizona investor") in the TCD. Requiring the deposition of a Division witness is entirely consistent with long-standing Commission practice. Indeed, the Commission's Procedural Rules specifically provide parties a right to depose witnesses. A.A.C. R14-3-109(P)(the "Deposition Rule"). Remarkably, the Division's 20-page response addresses the Commission's Deposition Rule only in

¹ Temporary Order to Cease and Desist and Notice of Opportunity for Hearing dated December 10, 2010.

1 part of a lone footnote. Rather than squarely addressing this rule, the Division variously
2 pontificates about its views of the facts of the case, federal due process rights, and various statutes.
3 The Division's lengthy ruminations on these topics are irrelevant; the Deposition Rule specifically
4 allows parties to depose witnesses. Further, long-standing Commission practice and precedent
5 clearly supports a right to depose the Division's witnesses. Thus, the Respondents' motion should
6 be granted.

7 **II. The Commission's rules provide broad discovery rights, including the specific right to**
8 **depose witnesses.**

9 **A. The Commission's rules grant broad discovery rights.**

10 The Commission's Rules of Practice and Procedure ("Procedural Rules") are set forth in
11 A.A.C. R14-3-101 et seq. The Procedural Rules apply to both Securities Division and Utilities
12 Division cases. A.A.C. R14-3-101.A. There is no distinction between Securities and Utilities
13 cases with respect to the Procedure Rules. *Id.* The Procedural Rules expressly incorporate the
14 Arizona Rules of Civil Procedure, including those rules governing discovery. *Id.* Thus, discovery
15 in the Division's cases is governed by the Commission's own Procedure Rules and the Arizona
16 Rules of Civil Procedure.

17 Numerous Commission decisions have noted the broad discovery rights available under the
18 Procedural Rules.² Likewise, many Commission Procedural Orders describe the broad discovery
19 rights available under the Procedural Rules. As Assistant Chief ALJ Nodes noted in a Procedural
20 Order in the recent LPSCO rate case, "[t]he standard for conducting discovery is intentionally
21 broad."³ Judge Nodes specifically applied the Rules of Civil Procedure, including the rule allowing
22

23
24 ² See e.g. Decision No. 70355 (May 16, 2008) at Finding of Fact No. 9 (noting granting of motion
25 to compel) and Decision No. 66984 (May 11, 2004) at Finding of Fact No. 55 (same); Decision No.
26 70011 (Nov. 27, 2007) at 48 (rejecting new argument raised by utility due to "insufficient time to
27 conduct discovery."); Decision No. 67454 (January 4, 2005)(discussing "reasonably calculated to
lead to the discovery of admissible evidence" discovery standard); Decision No. 65121 (August
23, 2002) (at Finding of Fact No. 8)(noting that a hearing was vacated and rescheduled in order to
allow for further discovery).

³ Procedural Order dated November 23, 2009 in Docket Nos. SW-01428A-09-0103 at p. 5.

1 all discovery requests “reasonably calculated to lead to the discovery of admissible evidence.”⁴
2 ALJ Rodda applied that same standard in denying a motion to quash a subpoena in another recent
3 Procedural Order.⁵ To the same effect is Judge Nodes’ earlier Procedural Order applying the Rules
4 of Civil Procedure to a motion to compel.⁶ These Procedural Orders all recognize that the
5 Commission’s Procedural Rules incorporate the Rules of Civil Procedure and allow the same broad
6 discovery allowed in civil cases.

7 None of this is any surprise to the Division – broad discovery has been standard practice in
8 Commission cases (both Utilities and Securities) for decades. In case after case, the Division has
9 refused to participate in discovery until compelled to do so by the Administrative Law Judge (ALJ).
10 And in case after case, ALJs have rejected the Division’s position and ordered it to comply with
11 discovery. For example, over twenty years ago, the Division filed a motion for “waiver of civil
12 discovery”; the motion was denied.⁷ This pattern has continued year after year, down to the
13 present day. For example, the Division refused to provide discovery in the Hockensmith case;⁸ the
14 ALJ disagreed and ordered the Division to provide discovery. Likewise, the Division was
15 compelled to provide discovery in the Yucatan case,⁹ and in the Reserve Oil case.¹⁰

16 **B. The Commission’s rules give parties the right to depose witnesses.**

17 The Commission’s rules provide that “The Commission, a Commissioner, or any party to a
18 proceeding before it may cause the depositions of witnesses to be taken in the manner prescribed by
19 law and of the civil procedure for the Superior Court of the state of Arizona.” A.A.C. R14-3-
20 109(P). The Deposition Rule is clear – a “party... may cause” the deposition of “witnesses”. The
21 Division does not dispute that the Respondents are parties, or that Mr. Hanselman is a witness.
22 Thus, under the plain meaning of the Deposition Rule, Respondents may depose Mr. Hanselman.

23
24 ⁴ Id., citing Arizona R. Civ. Pro. 26(b)(1)(A).

25 ⁵ Procedural Order dated November 13, 2009 in Docket Nos. RT-00000H-97-0137 at p. 2.

26 ⁶ Procedural Order dated August 11, 2006 in Docket No. T-03632A-06-0091.

27 ⁷ Procedural Order dated February 10, 1989 in Docket No. S-2430-I.

⁸ Docket No. S-20631A-08-0503.

⁹ Docket No. S-03539A-03-0000.

¹⁰ Docket No. S-20437A-05-0925.

1 While the text of the rule is clear, long-standing practice also supports a right to depose
2 witnesses. In his recent LPSCO procedural order, Assistant Chief ALJ Nodes stated that “[a]s is
3 clear from both the subsequent statute, A.R.S. § 40-244, and the Commission’s rule in A.A.C. R14-
4 3-109(P), the Commission, an individual Commissioner, or “any party” may take depositions.
5 Further, Ariz. R. Civ. P. 26(b) allows discovery to be undertaken “through interrogatories or by
6 deposition,” evidencing the interchangeable nature of either of those discovery tools under the rules
7 of civil procedure.”¹¹

8 Nor are depositions limited to Utilities cases. As previously noted, the same procedural
9 rules apply to both Utilities and Securities cases. And, for example, a Division witness was
10 deposited in the Reserve Oil case.¹²

11 **C. The Division interpretation of the Deposition Rule is not supported by the text**
12 **of the rule or Commission practice.**

13 In the Division’s 20-page response, it addresses the Deposition Rule in part of one footnote.
14 The Division’s entire analysis is “Respondents also cite A.A.C. R14-3-109(P) relating to
15 depositions. However, that rule is subject to the limitations and “reasonable need” requirement set
16 forth above.”¹³ This footnote appears to refer to A.R.S. § 41-1062(A), which does contain
17 “reasonable need” language. Importantly, however, that statute allows agencies to grant greater
18 discovery rights by rule – which the ACC has done in its Procedural Rules, including the
19 Deposition Rule. The statute provides:

20 ...
21 4. The officer presiding at the hearing may cause to be issued subpoenas for the
22 attendance of witnesses and for the production of books, records, documents and
23 other evidence and shall have the power to administer oaths. **Unless otherwise**
24 **provided by law or agency rule**, subpoenas so issued shall be served and, upon
25 application to the court by a party or the agency, enforced in the manner provided
26 by law for the service and enforcement of subpoenas in a civil action. On
27 application of a party or the agency and for use as evidence, the officer presiding
at the hearing may permit a deposition to be taken, in the manner and upon the
terms designated by him, of a witness who cannot be subpoenaed or is unable to
attend the hearing. Prehearing depositions and subpoenas for the production of

¹¹ Procedural Order dated November 23, 2009 in Docket Nos. SW-01428A-09-0103 at p. 5.

¹² Decision No. 70630 (December 9, 2008) at Findings of Fact Nos. 38-46.

¹³ Division Response at p. 15, footnote 14.

documents may be ordered by the officer presiding at the hearing, provided that the party seeking such discovery demonstrates that the party has reasonable need of the deposition testimony or materials being sought. All provisions of law compelling a person under subpoena to testify are applicable. Fees for attendance as a witness shall be the same as for a witness in the superior courts of the state of Arizona, unless otherwise provided by law or agency rule. **Notwithstanding the provisions of section 12-2212, no subpoenas, depositions or other discovery shall be permitted in contested cases except as provided by agency rule or this paragraph.**

A.R.S. § 41-1066(A)(emphasis added). Indeed, Assistant Chief ALJ Nodes rejected the same § 41-1062 argument in his LPSCO Procedural Order: “RUCO’s reliance on A.R.S. § 41-1062 as a basis to quash the subpoena is misplaced” because under the Commission’s Deposition Rule “the Commission, an individual Commissioner, or “any party” may take depositions.”¹⁴

While the Division may wish that the Commission had adopted different discovery rules, it must abide by the rules actually passed by the Commission. Indeed, the Commission has a legal duty to follow its own rules. *Gibbons v. Arizona Corp. Comm’n*, 95 Ariz. 343, 347, 390 P.2d 582, 585 (1964)(Commission must follow its own rules); *George v. Arizona Corp. Comm’n*, 83 Ariz. 387, 390, 322 P.2d 369, 371 (1958)(same); *Tucson Warehouse & Transfer Co. v. Al’s Transfer, Inc.*, 77 Ariz. 323, 327-328, 271 P.2d 477, 479-80 (1954)(the Commission’s “methods of procedure have the effect of law... and must be followed by it so long as they are in force and effect.”); *see also LaWall v. Pima County Merit Sys. Comm’n*, 212 Ariz. 489, 494, 134 P.3d 394, 399 (Ct. App. 2006)(administrative rule has force of law). Here, the Commission’s Deposition Rule states that a “party... may cause” the deposition of “witnesses”. Because the Respondents are parties, and Mr. Hanselman is a witness, that’s the end of the matter.

III. The Division’s constitutional, statutory and factual arguments are without merit.

The Division vociferously argues that the United States Constitution does not confer a due process right to discovery in administrative proceedings.¹⁵ The Division attacks a straw-man. The ALJ will search Respondents’ motion in vain for any reference to constitutional due process rights. The Respondents’ motion is instead based on the Commission’s Procedural Rules, including the

¹⁴ Procedural Order dated November 23, 2009 in Docket Nos. SW-01428A-09-0103 at p. 5.

¹⁵ Division Response at 13-15.

1 Deposition Rule.

2 The Division also argues that this case is governed by the Commission's Procedural Rules,
3 not the rules of civil procedure. The Division thus argues that the *Slade* case does not apply,
4 because that case concerned the rules of civil procedure. But as already noted, the Commission's
5 Procedural Rules incorporate the civil rules, and numerous Commission Procedural Orders refer to
6 the rules of civil procedure in resolving discovery disputes. Moreover, the Deposition Rule itself
7 directly incorporates the rules of civil procedure, stating that "depositions of witnesses [are] to be
8 taken in the manner prescribed by law and of the civil procedure for the Superior Court." Thus,
9 *Slade* is directly on point. *Slade* specifically found that the Commission must "disclose the names
10 of the investors referred to in the investigator's entire affidavit and any materials upon which the
11 investigator relied in compiling or assessing the information disclosed in the affidavit." *See Slade*
12 *v. Schneider*, 212 Ariz. 176, 181-82 ¶ 32, 129 P.3d 465, 470-71 (Ct. App. 2006). Here, the
13 Division has set forth broad allegations against the Respondents in the TCD. If the Division
14 wanted to shield its file on such matters, it should not have issued such a broadly-worded TCD. In
15 short, Respondents have the right under *Slade* to inquire into the names of the supposed potential
16 investors and "any materials upon which the investigator relied in compiling or assessing the
17 information disclosed in" the TCD. And under the Commission's Deposition Rule, they may do so
18 by taking the deposition of the Division's investigator.

19 The Division refers in passing to the confidentiality section of the Securities Act, A.R.S. §
20 44-2042. That statute provides, *inter alia*, "An officer, employee or agent of the commission shall
21 not make the confidential names, information or documents available to anyone,... **except**
22 **pursuant to any rule of the commission** or unless the commission or the director authorizes the
23 disclosure of the names, information or documents as not contrary to the public interest."
24 (emphasis added) The Deposition Rule is, of course, a "rule of the commission." To the extent
25 some Division materials should not be disclosed to the public, that can be addressed by a
26 confidentiality agreement or protective order, without impeding discovery, as is often done in
27 Commission cases. To the extent the Division is arguing that this statute provides a reason to

1 distinguish utilities cases from securities cases, it is incorrect. A.R.S. § 40-204.C requires that “no
2 information” provided by utilities “shall be open to public inspection or made public” except when
3 authorized by the Commission. Both A.R.S. § 40-204.C and A.R.S. § 44-2042 are broad statutes
4 that render information confidential, except when public release is authorized by the Commission.
5 If there is a difference between utilities and securities cases, the existence of a confidentiality
6 statute is not it.

7 The Division also asserts that Respondents “have failed to properly consider available,
8 reasonable alternatives to a pre-hearing, discovery deposition of Mr. Hanselman including their
9 ability to cross-examine and confront Mr. Hanselman at an evidentiary hearing....”¹⁶ The Division
10 has it backwards; the purpose of cross-examination is not discovery. Rather, the point of discovery
11 is to avoid wasting scarce and expensive hearing time with discovery questions, and to avoid
12 surprise and the need for possible continuances based on newly-disclosed information. As
13 Assistant Chief ALJ Nodes explained, the “standard for discovery is intentionally broad to allow
14 parties to a proceeding to prepare for hearing or trial and to mitigate the necessity for unnecessary
15 discovery-based cross-examination on the witness stand.”¹⁷

16 The Division attempts to minimize the role of Special Investigator Hanselman, implying
17 that he is some minor functionary with little involvement in the case, claiming that he “did not
18 prepare, sign or file the TC&D.”¹⁸ The Division’s implicit suggestion that Respondents depose the
19 Commission employees who did “prepare, sign or file the TC&D” is helpful, and Respondents will
20 pursue that avenue of discovery. But Respondents still have a right to depose Mr. Hanselman. He
21 is a witness. He is the only Division employee (as far as we know) to have communicated with
22 Respondents during the investigation leading to the TCD. He was the one who contacted the
23 Respondents; it was his investigation. He was the one who falsely stated he was an accredited
24 investor. The Respondents are entitled to ask him about his investigation, to discuss his
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26 ¹⁶ Division Response at p. 10.

27 ¹⁷ Procedural Order dated November 23, 2009 in Docket Nos. SW-01428A-09-0103 at p. 5.

¹⁸ Division Response at 12.

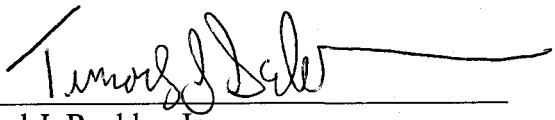
ROSHKA DeWULF & PATTEN, PLC
ONE ARIZONA CENTER
400 EAST VAN BUREN STREET - SUITE 800
PHOENIX, ARIZONA 85004
TELEPHONE NO 602-256-6100
FACSIMILE 602-256-6800

1 communications with them, and his methods, and the reason he made false statements to them, as
2 well as why he did not pursue further communications.

3 Lastly, the Division claims that any deposition of Mr. Hanselman would invade the
4 attorney-client privilege and the work-product doctrine. However, whether the attorney-client
5 privilege and the work-product doctrine applies can only be determined on a question-by-question
6 basis. The Division may object to specific questions; it may not make a blanket objection to every
7 possible question. For example, in *Lietz v. Primock*, 84 Ariz. 273, 327 P.2d 288 (1958), the
8 Arizona Supreme Court found that even when an attorney was the witness, not all deposition
9 questions were covered by the privilege.

10 RESPECTFULLY SUBMITTED this 22nd day of March, 2011.

11 ROSHKA DeWULF & PATTEN, PLC

12
13 By 

14 Paul J. Roshka, Jr.
15 Timothy J. Sabo
16 Jennifer A. Baker
17 One Arizona Center
18 400 East Van Buren Street, Suite 800
19 Phoenix, Arizona 85004
20 602-256-6100 (telephone)
21 602-256-6800 (facsimile)

22 Attorneys for All Respondents

23 ORIGINAL and thirteen copies of the foregoing
24 filed this 22nd day of March, 2011 with:


25 Docket Control
26 Arizona Corporation Commission
27 1200 West Washington Street
Phoenix, Arizona 85007

ROSHKA DEWULF & PATTEN, PLC
ONE ARIZONA CENTER
400 EAST VAN BUREN STREET - SUITE 800
PHOENIX, ARIZONA 85004
TELEPHONE NO 602-256-6100
FACSIMILE 602-256-6800

1 Copy of the foregoing hand-delivered
this 22nd day of March, 2011 to:

2 Marc E. Stern, Administrative Law Judge
3 Hearing Division
4 Arizona Corporation Commission
1200 West Washington Street
5 Phoenix, Arizona 85007

6 Matt Neubert, Esq.
7 Michael Dailey, Esq.
8 Securities Division
9 Arizona Corporation Commission
1300 West Washington Street, 3rd Floor
Phoenix, Arizona 85007

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